In the Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-73

AMF INCORPORATED, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioner instituted this income tax refund suit in the United States Court of Claims, contending that it was entitled to interest deductions on account of alleged amortizable original issue discount on convertible debentures that it had sold at par. The court sustained the determination by the Commissioner of Internal Revenue that no original issue discount arises upon the sale of convertible debentures at par and dismissed petitioner's suit (Pet. App. A). Petitioner here renews its claims that the sale of convertible debentures at par gives rise to amortizable original issue discount.

The debentures here in question were issued by petitioner in 1961. They bear annual interest at the rate of 4 1/4 percent and mature in 1981; at the time of issue, each $100 par value debenture was convertible into 5/6 share of petitioner's common stock,[1] and the

[1] Shortly after issuance of the debentures, the conversion rate was adjusted for a two-to-one stock split.

debentures remained convertible until March 1, 1981. The debentures were sold at par in the aggregate amount of $39,911,100. However, petitioner contends that $3,591,999 of the issue price was received on account of the conversion feature alone and that the portion of the debentures representing borrowing was therefore actually sold at a discount. It is that alleged discount which petitioner seeks to amortize, as an added cost of borrowing, over the term of the debentures.

1. In opposing petitioner's petition for a writ of certiorari, we rely primarily upon the opinion below (Pet. App. A). The convertible feature of the debenture added nothing to petitioner's borrowing costs and therefore did not give rise to amortizable bond discount. When a convertible debenture is sold at par, the issuer has no borrowing costs other than stated interest. This is true whether the debenture is held to maturity or converted into common stock.

In neither event is there any "cost of the borrowed capital" (*Helvering* v. *Union Pacific Co.*, 293 U.S. 282, 287) beyond stated interest. And as the court below properly observed (Pet. App. A, p. 2a), "for there to be a [deduction on account of original issue] discount there must be an added cost to the issuer, over and above the stated interest, for the use of the payee's capital."

2. As petitioner acknowledges (Pet. 8), the decision below is in accord with the only other decisions on this issue, *Chock Full O'Nuts Corp.* v. *United States*, 453 F. 2d 300 (C.A. 2), and *Hunt Foods & Industries Inc.* v. *Commissioner*, 57 T.C. 633 (appeal pending in C.A. 9). Petitioner contends (Pet. 3-8), however, that there is a conflict in reasoning between the decision below and *National Alfalfa Dehydrating and Milling*

Co. v. *Commissioner*, 472 F. 2d 796 (C.A. 10), government's petition for a writ of certiorari pending, No. 73-9. We agree that there is an inconsistency in the broad sense that the court of appeals in *National Alfalfa* misapplied the fundamental principle, recognized and properly applied by the court below in this case, that amortization of an alleged original issue discount is permissible only where the taxpayer has established the existence of borrowing costs in excess of stated interest. There is, however, no conflict of decisions "on the same matter" (Rule 19(1)(b) of the Rules of this Court) which requires resolution by this Court.

The issue in *National Alfalfa* was whether, when debentures are issued in lieu of preferred stock as part of a reorganization of corporate capital structure, either the market value or the par value of the preferred stock is relevant to the determination of the existence of amortizable bond discount. That question is factually far afield from the one presented here. Moreover, the rationale employed by the Tenth Circuit in deciding that case would not help petitioner. The Tenth Circuit, in holding the difference between the market value of the preferred stock and the par value of the debentures to be amortizable bond discount, reasoned that to determine the existence of amortizable discount it is sufficient merely to compare the fair market value of the property received immediately in substitution for the debentures with the par value of the debentures themselves. Under this reasoning petitioner would still be denied any deduction for bond discount, for the cash it received for its debentures was in fact equal to their par value. Thus, the Tenth Circuit's decision and opinion in *National Alfalfa* do not indicate that that court would have decided the present case differently from the court below.

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

DANIEL M. FRIEDMAN,
*Acting Solicitor General.**

SEPTEMBER 1973.

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* In place of the Solicitor General, who is disqualified for personal reasons.

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